the BOC interexchange affiliate's relationships to all of its affiliates, regulated and nonregulated. In the absence of such a four-way scheme, the Commission will not be able to prevent cross-subsidies between the BOC's local exchange operations and its interexchange operations as well as between its interexchange operations and its nonregulated operations and affiliates. Both of those possible sources of cross-subsidies pose a threat to BOC monopoly ratepayers and to interexchange competition.

This issue raises another related problem -- namely, the long-pending docket examining the Commission's affiliate transaction rules.[29] The comment cycle in that docket closed on January 10, 1994, and the flurry of critical audit reports that have been released since then confirms the urgency of the issues raised therein. MCI explained in its comments in that docket that the affiliate transaction rules need to be tightened up in several respects to prevent cross-subsidization of nonregulated affiliates by regulated ratepayers. As explained above, price caps have not, and cannot, remove the incentives and ability to cross-subsidize.

Among the modifications that should be made to the affiliate transaction rules are the following:

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[29] Notice of Proposed Rulemaking (NPRM), Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions between Carriers and Their Nonregulated Affiliates, CC Dkt. No. 93-251, FCC 93-453 (released Oct. 20, 1993).

- the valuation rules for asset transfers (*i.e.*, lower of cost or fair market value (FMV) for transfers to the regulated entity, and the higher of cost or FMV for transfers to the nonregulated entity) should also be applied to transfers of services;
- "prevailing company" pricing for a nonregulated affiliate service or product should only be allowed where at least 75 percent of the nonregulated affiliate's revenue from that service or product, or product line, is obtained through sales to third parties;
- these changes in affiliate transaction valuation methodologies should be given exogenous treatment, to ensure that any resulting savings to regulated entities are passed on to ratepayers;
- for those nonregulated affiliate services that must be valued at cost, the Commission should apply the generic rate base methodology proposed in the *NPRM* in CC Docket 93-251, but using the lowest rate of return allowed under any of the Commission's alternative regulatory plans;
- CAMs should be improved by identifying which entities and product lines meet the "75 percent test," identifying any rate of return other than the prescribed one used for setting costs of nonregulated services and products; and describing the procedures used for estimating FMV.

The recent audits reinforce the need for these improvements in the affiliate transaction rules, which should be applied to the BOCs' interexchange affiliates.

B. The BOCs' Interexchange Affiliates Should be Required to Maintain Their Books Pursuant to Parts 32 and 36 of the Commission's Rules

The Commission also should require the BOCs' interexchange affiliates to maintain their books pursuant to the Part 32 Uniform System of Accounts (USOA). The importance of Part 32 accounting is underscored by the possibility raised in the Notice that the Commission might consider, in the future, allowing the BOCs to provide out-of-region interexchange services on a nondominant basis free of any separate affiliate requirement. This possible outcome makes it especially important that the costs of providing interexchange service be recorded according to Part 32. By mandating use of the USOA now, the Commission can avoid later problems arising from the merging of a non-USOA system with the BOCs' existing USOA local exchange service books.

There are also other reasons to require the BOCs' interexchange operations to utilize Part 32 accounting. The audits discussed above found such a lack of documentation that the BOCs' compliance with the Commission's accounting requirements could not be substantiated. The audits also found misclassifications of costs, resulting in overallocations to ratepayers.

These audit findings should serve as a warning for regulators seeking to create a competitively-neutral telecommunications environment. The BOCs' historical unwillingness to adhere to established accounting rules strongly suggests that regulators should put themselves in a position to carefully monitor BOC separate interexchange affiliates. Requiring such affiliates to keep their books pursuant to Part 32 accounting will help achieve that goal by enhancing the ability of regulators to conduct audits. Utilizing the Part 32 USOA helps to ensure that records are kept in a format that is familiar to regulators, and also helps ensure that a sufficient level of detail is maintained. Part 32 accounting also facilitates comparisons between accounts. The costs of imposing this requirement on the BOCs' interexchange affiliates now are low but will become much greater if they begin providing interexchange services without such a requirement.

The Commission should also require the BOCs' interexchange affiliates to keep Part 36 Separations Accounts. Presumably, those affiliates would be offering both interstate and intrastate interexchange services. As discussed above, the Notice suggests that the Commission at some point may decide to permit the BOCs to offer out-of-region interexchange services on a nondominant basis without a separate affiliate requirement. The Commission needs to understand the impact that a joint intrastate (local and interexchange)/interstate offering would have on jurisdictional separations results. Since the separations rules utilize allocators based on usage, it is highly likely that the BOCs' interexchange operations will produce a shift in their jurisdictional revenue requirements. Even in a regulatory system such as price caps, revenue requirements play a key role in sharing obligations and the Commission's ability to monitor earnings on a consistent basis.

CONCLUSION

For the above reasons, the Commission should require the BOCs to offer their out-of-region interexchange services through separate affiliates as dominant carrier services. The Commission should also ensure the effectiveness of those requirements by imposing stringent separate affiliate transaction rules on such affiliates and by requiring such affiliates to keep their books pursuant to Parts 32 and 36 of the Commission's Rules.

Finally, the Commission should commit to respond quickly to marketplace abuses resulting from BOC participation in the interexchange service market. The continued vitality and growth of that industry require no less. The development of the interexchange service market must never again be held hostage to local bottleneck power.

Respectfully submitted,

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Dated: March 13, 1996

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of: Petition Requesting that Any Interstate Non-Access Service Provided by Southern New England Telecommunications Corporation Be Subject to Non-Dominant Carrier Regulation	)	CCB Pol 96-03 DA 96-72

COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION

MCI TELECOMMUNICATIONS CORPORATION

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Dated: February 26, 1996

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SUMMARY

SNET's Petition for Declaratory Ruling that its interstate interexchange and other non-access services are "nondominant" under the Commission's Competitive Carrier criteria, and thus may be provided on an unseparated basis, should not be granted, for both procedural and substantive reasons. SNET's request is premature, in light of the Commission's ongoing review of the Competitive Carrier criteria and other proceedings, and, if it were reviewed on the merits now, it would have to be denied.

Previously, the Commission has considered analogous LEC requests for nondominant regulatory treatment only in the context of the Competitive Carrier rulemaking, and the Commission is now considering, in the Price Cap Performance Review rulemaking proceeding, the criteria that should be applied to all such requests. More specifically, the Commission has requested comments as to whether it should adopt rules defining the conditions LECs must meet to be considered nondominant and whether such conditions should be different from the Competitive Carrier criteria. Until the Commission determines the criteria for LEC nondominance, it cannot act on any LEC requests for nondominant status.

The prematurity of SNET's request is confirmed by the risk that a decision on the merits now might be inconsistent with policies that may be established in other proceedings. In the BOC Out-of-Region proceeding, the Commission has proposed that BOC out-of-region interexchange services be granted nondominant

status on condition that they are offered through separate affiliates. Given that LEC or BOC in-region interexchange services pose a greater threat of cross-subsidization and discrimination than LEC or BOC out-of-region services and that this threat is magnified where such services are offered on an unseparated basis, the relief SNET seeks -- nondominant status for in-region unseparated interexchange services -- is clearly incompatible with the Commission's tentative conclusion in the BOC Out-of-Region proceeding. Similarly, the relief SNET seeks may be inconsistent with policies that the Commission might wish to establish in future LEC forbearance proceedings conducted under the new Section 10 of the Communications Act. The Commission should not box itself into undesirable industry-wide policies by granting relief in individual cases before it has had a chance to consider the broader implications of such relief.

If the Commission were to consider SNET's request on the merits, it would have to be denied on account of SNET's continuing local bottleneck power and demonstrated incentive to use that power anticompetitively. Competitive Carrier established that control over the local exchange network gives BOCs and other LECs the ability to discriminate against other entities requiring access to that network and to shift costs to the detriment of ratepayers and competitors and that this advantage is not diminished by the happenstance of a small LEC market share in the competitive service for which access is needed. Separation of a LEC's interexchange operations from its local exchange services helps to minimize cross-subsidies and access discrimination against competing IXCs. _Competitive Carrier_ accordingly required LEC interexchange services to be regulated as dominant unless they were provided through a separate affiliate.

Moreover, SNET's local bottleneck power and incentive to use it anticompetitively have not been diminished by the federal and state regulatory policies SNET cites. Recent federal and state audits of various LECs have demonstrated that the Commission's cost allocation and other accounting rules have not eliminated LECs' abilities to cross-subsidize, and the continuation of such behavior under price caps demonstrates that price cap regulation has not dampened the LECs' incentives to cross-subsidize.

The _Expanded Interconnection_ rules and the Connecticut DPUC's authorization of local and access service competitors are steps in the right direction, but they have not yet resulted in any significant local or access service competition to SNET. One factor impeding the expected development of competition from the DPUC's policies is SNET's failure to file cost justified rates for unbundled local service elements and wholesale local service or an interconnection tariff that reflects the DPUC's requirements. SNET's reluctance to carry out the DPUC pro-competitive policies it cites, as well as its excess intrastate earnings, undermine its claim of nondominance.

SNET also fails to support its claim that "market realities" remove any incentive to exercise, in the interexchange market, whatever bottleneck power it may still possess. SNET's service area, essentially the state of Connecticut, is a significant market by any relevant measure. An IXC attempting to offer nationwide service would be adversely affected by SNET's discrimination or cross-subsidies. It is irrelevant that SNET is smaller than some other LECs or BOCs that do not compete with it. Within its service area, SNET enjoys virtually total control of all local and access services, and the provision of interexchange service originating or terminating in that service area is more than a sufficient prize to motivate anticompetitive behavior by SNET.

Finally, the need for a strict imputation requirement precludes nondominant status for any LEC in-region interexchange service. The Commission has consistently required the uniform, nationwide application of all switched access charges to the origination and termination of all carriers' interexchange services. The purpose of the imputation rule is to make LECs "pay" full access charges when acting as IXCs, in order to prevent them from subjecting their competitors to a price squeeze (beyond that which IXCs already bear on account of the excessiveness of access charges). LECs must therefore file sufficient cost support with any interexchange tariff, and with sufficient notice, to permit the analysis necessary to determine compliance with the imputation rule, thus precluding nondominant treatment for any LEC in-region unseparated interexchange service.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of: Petition Requesting that Any Interstate Non-Access Service Provided by Southern New England Telecommunications Corporation Be Subject to Non-Dominant Carrier Regulation	)	CCB Pol 96-03 DA 96-72

COMMENTS OF MCI TELECOMMUNICATIONS CORPORATION

MCI Telecommunications Corporation (MCI), by its undersigned attorneys, hereby submits its comments on the Petition of Southern New England Telecommunications Corporation for Declaratory Ruling that its interstate interexchange and other non-access services are "nondominant" under the Commission's Competitive Carrier[1/] proceeding and may therefore be provided on an unseparated basis.[2/] As explained below, the relief sought by

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[1/] Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Therefor, CC Docket No. 79-252, Notice of Inquiry and Proposed Rulemaking (Competitive Carrier Notice), 77 FCC 2d 308 (1979); First Report and Order (First Report), 85 FCC 2d 1 (1980); Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1981); Second Further Notice of Proposed Rulemaking, 47 Fed. Reg. 17308 (1982); Second Report and Order (Second Report), 91 FCC 2d 59 (1982), recon. denied, 93 FCC 2d 54 (1983); Third Report and Order (Third Report), 48 Fed. Reg. 46791 (1983); Fourth Report and Order (Fourth Report), 95 FCC 2d 554 (1983), vacated, AT&T v. FCC, 978 F.2d 727 (D.C. Cir. 1992), cert. denied, MCI Telecommunications Corp. v. AT&T, 113 S. Ct. 3020 (1993); Fourth Further Notice of Proposed Rulemaking, 96 FCC 2d 1191 (1984); Fifth Report and Order (Fifth Report), 98 FCC 2d 1191 (1984); Sixth Report and Order (Sixth Report), 99 FCC 2d 1020 (1985), vacated sub nom., MCI Telecommunications Corp. v FCC, 765 F.2d 1186 (D.C. Cir. 1985).

[2/] Pleading Cycle Established for Comments on SNET's Petition for Declaratory Ruling That Any Interstate Non-Access Service

Southern New England Telecommunications Corporation (SNET) should not be granted for several reasons, both procedural and substantive. Not only is SNET's request premature, in light of the Commission's ongoing review of the Competitive Carrier criteria, but it would also have to be denied on the merits, whatever standards should be applied.

SNET's Petition

Currently, SNET provides interstate interexchange services on a resale basis through its affiliate, SNET America, Inc. Because such services are offered through a separate affiliate, they are accorded nondominant regulatory treatment pursuant to the Fourth Report and Fifth Report in the Competitive Carrier proceeding.[3/] If they were offered on an unseparated basis by SNET itself, they would be treated as dominant services.[4/] SNET argues that the original rationale for requiring local exchange carrier (LEC) interexchange services to be provided by a separate affiliate as a condition for nondominant treatment no longer applies to its interexchange services for two reasons: (1) federal and state regulatory developments since the Competitive Carrier proceeding have loosened SNET's local bottleneck power and otherwise diminished its ability to leverage into the

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Provided by SNET be Subject to Non-Dominant Carrier Regulation, Public Notice DA 96-72 (released January 25, 1996).

[3/] See Fourth Report, 95 FCC 2d at 575-79; Fifth Report, 98 FCC 2d at 1195-1200.

[4/] Fifth Report, 98 FCC 2d at 1198-99.

interexchange market whatever market power it may retain in the local exchange and access markets; and (2)SNET's relatively small size and the characteristics of the interexchange market remove any incentive it might have had to exercise any such leverage.

As to the first point, SNET cites such developments as this Commission's cost allocation and other accounting regulations (including ARMIS), price cap regulation,[5] equal access regulations applicable to the LECs, and its Expanded Interconnection rules.[6] SNET also points to the Connecticut Department of Public Utility Control (DPUC) requirements of dialing parity for in-state toll calls and two-carrier presubscription, the DPUC price cap regulation of local exchange service, and the DPUC's authorization of local exchange service competition and related requirements that SNET provide competing exchange carriers with exchange resale on a wholesale basis,

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[5] Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786 (1990), recon., 6 FCC Rcd. 2637 (1991), aff'd sub nom. National Rural Telephone Ass'n. v. FCC, 988 F.2d 174 (D.C. Cir. 1993).

[6] Expanded Interconnection with Local Telephone Company Facilities, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369 (1992), recon., 8 FCC Rcd 127 (1992), vacated in part and remanded sub nom. Bell Atlantic Telephone Cos. v. FCC, 24 F.3d 1441 (D.C. Cir. 1994); further recon., 8 FCC Rcd 7341 (1993), Second Report and Order and Third Notice of Proposed Rulemaking, 8 FCC Rcd 7374 (1993), vacated in part and remanded sub nom. Bell Atlantic Telephone Cos. v. FCC, No. 93-1743 (D.C. Cir., filed April 17, 1995); Memorandum Opinion and Order, 9 FCC Rcd 5154 (1994), appeal docketed sub nom. Southwestern Bell Telephone Co. v. FCC, No. 94-1547 (D.C. Cir. Aug. 10, 1994); Expanded Interconnection with Local Telephone Company Facilities, Transport Phase II, Third Report and Order, 9 FCC Rcd 2718 (1994).

unbundled local exchange service, interconnection, mutual compensation and number portability.

As to the second point, SNET argues that its small percentage of all access services in the United States and the presence of well-established interexchange competitors deprive it of any incentive to try to leverage its local bottleneck power into the nationwide interexchange market. SNET concludes that because of these developments, its unseparated provision of interexchange service will not pose a threat of cross-subsidization or discrimination against interexchange competitors and that, under the rationale of the Competitive Carrier proceeding, there is therefore no longer any need to require that its interexchange services be provided through a separate affiliate to be accorded nondominant treatment.

SNET's Market

Although SNET attempts to depict itself as an insignificant factor in the relevant telecommunications markets, and bases its request partially on its alleged insignificance, the reality is quite the opposite. To get an idea of the relative importance of the market in which SNET operates, it is useful to keep in mind that Connecticut ranked eighth out of the 50 states in the number of originating intraLATA toll calls completed and 18th in the number of interLATA calls in 1994.[7] It ranked 22nd in the number of switched access lines -- over 2 million.[8] Its total revenue of almost $1.5 billion in 1994 placed it in the top 10 single-state BOCs and LECs,[9] and it had over $4 billion total plant in service at the end of 1994.[10] SNET's implicit plea that its size renders de minimis any possible cross-subsidization or discrimination that may result from its unseparated provision of interexchange services thus must be rejected. What happens in SNET's market will have a significant impact on interstate interexchange services. In the event that the Commission decides to address SNET's request on the merits, therefore, it must srutinize SNET's claims extremely carefully.

I. SNET's REQUEST IS PREMATURE

It would be inappropriate for the Commission to grant relief of the type sought by SNET at this time. Previously, the Commission has considered analogous LEC requests for nondominant treatment only in the context of rulemaking proceedings, and the Commission is now in the midst of a rulemaking that is intended to formulate criteria precisely for these types of requests.

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[7] FCC, Statistics of Communications Common Carriers at Table 2.6, Report No. CC95-73 (released Dec. 14, 1995).

[8] Id. at Table 2.4.

[9] Id. at Table 2.1.

[10] Id. at Table 2.9 (page 86).

In successive orders in the Competitive Carrier proceeding, the Commission reviewed the competitive conditions and market forces faced by different categories of carriers, and, as competitive conditions developed, granted or denied them nondominant status.[11/] The measured approach taken by the Commission in the Competitive Carrier rulemaking reflects the complex economic and regulatory issues that must be resolved before determining that a certain category of service or service provider may be afforded less stringent regulation. Determining such issues only in the context of general rulemakings has ensured that the entire regulatory scheme is internally consistent and that decisions as to particular categories of service or service provider are not made prematurely, without full consideration of the implications of such decisions for other services or categories of service provider.[12/] Accordingly, individual requests for less restrictive regulation were folded into the Competitive Carrier rulemaking, rather than addressed separately.[13/]

It would be especially inappropriate to resolve SNET's Petition now, when the Commission is considering in a pending

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[11/] See, e.g., Fifth Report, 98 FCC 2d at 1191-92, nn.1, 3 (summarizing previous orders).

[12/] See Competitive Carrier Notice, 77 FCC 2d at 333, ¶ 43.

[13/] See, e.g., Fifth Report, 98 FCC 2d at 1193, n.6. See also, RCA American Communications, Inc., 89 FCC 2d 1070, 1078, at ¶ 15 (1982).

rulemaking the criteria that should be applied to all such requests. In the Second Further Notice in the Price Cap Performance Review proceeding, the Commission has requested comments as to whether it should adopt rules defining the conditions LECs must meet to be considered nondominant and whether such conditions should be different from the criteria set forth in Competitive Carrier.[14] The Second Further Notice specifically references the previous Bell Operating Company (BOC) requests for nondominant status for various categories of interexchange services as examples of the type of request that could be governed by the rules it intends to issue in that proceeding and requests comments as to whether the criteria it adopts should be applied to those pending BOC requests.[15] Finally, the Second Further Notice requests comments on the procedures that LECs should follow in requesting nondominant status, including how LECs should meet their burden of proof.[16]

Obviously, until the Commission determines the criteria for LEC nondominance, the procedures that LECs must follow and how they must meet their burden of proof, the Commission cannot act

[14] Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, Price Cap Performance Review for Local Exchange Carriers, et al., CC Docket No. 94-1, et al., FCC 95-393 (released Sept. 20, 1995), at ¶ 154.

[15] Id. at ¶ 153 & n.231, ¶ 155 & n.235, ¶ 156 & n.240.

[16] Id. at ¶ 157.

on any LEC requests for nondominance, including SNET's Petition. It would make no sense for the Commission to render decisions about each of these similar requests, only to find down the road that it had unintentionally backed into a jerry-built policy as to LEC interexchange services that was inconsistent with the criteria and procedures to be set forth in the Price Cap Performance Review proceeding.

Furthermore, the recently passed telecommunications legislation, the Telecommunications Act of 1996 (1996 Act), also supports a deferral of SNET's Petition. Section 401 adds a new Section 10 to the Communications Act of 1934, 47 U.S.C. §§ 151 et seq., which requires the Commission to

> forbear from applying any regulation or any provision of this Act to a telecommunications carrier or telecommunications service, or class of ... carriers or ... services ... if ... -
>
> (1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that ... carrier or ... service are just and reasonable and are not unjustly or unreasonably discriminatory;
>
> (2) enforcement of such regulation or provision is not necessary for the protection of consumers; and
>
> (3) forbearance from applying such provision or regulation is consistent with the public interest.

In making the public interest determination under subsection (3), the Commission "shall consider whether forbearance ... will promote competitive market conditions ...."

Given the pendency of four BOC and LEC requests for nondominant treatment, it is likely that any consideration of such requests will be considered in the context of a forbearance proceeding as to one or more categories of LEC interexchange services conducted pursuant to this provision. It would make no sense to address SNET's request, as well as the three other pending requests for nondominant status, individually in advance of such a wide-ranging, generic forbearance review. In order not to create arbitrarily inconsistent policies, the Commission, if it were to rule on SNET's Petition now, would have to anticipate the precise contours of the regulatory scheme for LEC interexchange services that the Commission might put into place in a generic forbearance review, so that the regulatory treatment of SNET's interexchange services would not be inconsistent with the subsequent regulatory scheme that might govern all LEC interexchange services. That would be an impossible task.

The risk of inconsistent treatment arising from the individual consideration of pending LEC nondominant status requests, especially SNET's request, is exacerbated by the current proceeding addressing the possible nondominant treatment of BOC out-of-region interexchange services (BOC Out-of-Region).[17/] There, the Commission has proposed that such services be granted nondominant treatment only on condition that they are

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[17/] Notice of Proposed Rulemaking, Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, FCC 96-59, CC Docket No. 96-21 (released Feb. 14, 1996).

offered through separate affiliates. SNET's request for nondominant treatment for in-region interexchange services offered on an unseparated basis thus raises the distinct possibility of inconsistent regulatory policies. Although independent LECs historically have been treated differently from BOCs to some extent under Competitive Carrier, the Commission has never created such a wide regulatory gulf between them as would result if SNET's request were granted and the Commission adopted its tentative conclusions in the BOC Out-of-Region proceeding.[18/]

In-region interexchange services offered by an entity with local bottleneck power clearly raises a much greater threat of cross-subsidies and discrimination than out-of-region interexchange services offered by the same entity, and that threat is magnified where such services are offered on an unseparated basis.[19/] It would therefore be irrational to grant SNET, or any LEC, nondominant treatment for unseparated in-region interexchange services while requiring BOCs to provide out-of-region interexchange services through a separate affiliate in

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[18/] Such divergent policies toward LEC and BOC interexchange services would also conflict with SNET's suggestion (SNET Pet. at 6 n.16) that its interexchange services should be regulated no less stringently than BOC interexchange services. That suggestion also raises the further issue of possible inconsistency between SNET's requested relief and all of the requirements that will be imposed under the regulatory scheme that the Commission will put into place for BOC interexchange services in response to Section 151 of the new legislation.

[19/] Fourth Report, 95 FCC 2d at 575-79; Fifth Report, 98 FCC 2d at 1195-1200.

order for such services to be accorded nondominant treatment.

The Commission accordingly should defer any action on SNET's request until the conclusion of the BOC Out-of-Region proceeding and the current phase of the Price Cap Performance Review proceeding, as well as any LEC industry-wide forbearance proceeding conducted pursuant to the new legislation. The Commission should not risk boxing itself into undesirable industry-wide regulatory policies by granting relief in individual cases before it has had a chance to consider the broader implications of such relief.

II. SNET HAS NOT DEMONSTRATED THAT INTEREXCHANGE SERVICES IT PROVIDES ON AN UNSEPARATED BASIS SHOULD BE ACCORDED NONDOMINANT TREATMENT

A. The LECs' Local Bottleneck Control Requires Dominant Status for Their Unseparated Interexchange Services

Not only would it be inappropriate to entertain SNET's request at this time, but the request would also have to be denied if the Commission were to address its merits. Notwithstanding the regulatory developments SNET discusses, it still enjoys overwhelming bottleneck control over the local network, which can readily be brought to bear against interexchange competitors.

As the Commission explained in the First Report:

> An important structural characteristic of the marketplace that confers market power upon a firm is the control of bottleneck facilities. A firm

> controlling bottleneck facilities has the ability to impede access of its competitors to those facilities.... We treat control of bottleneck facilities as prima facie evidence of market power requiring detailed regulatory scrutiny.[20]

The reason for the Commission's approach is obvious. As set forth in Competitive Carrier, the BOCs' and other LECs' local bottleneck power would allow them to discriminate against competitors dependent upon access to the local network and to shift costs.[21] That advantage is not diminished by the happenstance of a small LEC market share in the competitive service for which network access is needed. The BOCs and other LECs could always argue (and do argue) that they start off in any new competitive market with a share of zero. That hardly indicates a lack of market power, however, given their local bottleneck control.

Separation of a LEC's interexchange operations from the LEC's network facilities helps to minimize cross-subsidization and access discrimination against competing interexchange carriers (IXCs).[22] The Commission emphasized that any entity, including LECs, providing unseparated services with mixed characteristics (i.e., some services in which the carrier is dominant and some in which it is nondominant), will be regulated

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[20] First Report, 85 FCC 2d at 21, ¶ 58 (emphasis added).

[21] First Report, 85 FCC 2d at 21-22; Fifth Report, 98 FCC 2d at 1195-99.

[22] Fourth Report, 95 FCC 2d at 575-79; Fifth Report, 98 FCC 2d at 1195-1200.

under the more stringent standard.[23] Thus, any LEC services, including interexchange services, provided on a joint basis with the LEC's local exchange services must be treated as dominant.

B. SNET Retains its Local Bottleneck Power and the Incentive to Use it Anticompetitively

SNET argues that regulatory and competitive developments since Competitive Carrier have weakened its bottleneck control and that, in any event, its supposedly small relative size and the existence of well-established interexchange competitors effectively stifle any incentive to use any remaining bottleneck control anticompetitively. Closer examination reveals, however, that these developments either have had no impact on SNET's local dominance or, at most, hold only a promise of a future loosening of its local bottleneck control. Moreover, SNET is certainly large enough to make it worthwhile to try to leverage its bottleneck power into the interexchange market.

1. This Commission's Regulations Have Not Weakened SNET's Dominance

SNET points to the cost allocation rules as a bulwark against cross-subsidization and the price cap rules as a disincentive to cross-subsidize. The cost allocation rules, however, have fallen short, as demonstrated by the results of recent LEC audits carried out by federal and state authorities.

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[23] Fourth Report, 95 FCC 2d at 579.

For example, in April 1994, the Commission and the GTE Telephone Companies (GTOCs) entered into a Consent Decree settling issues arising out of an audit of the transactions between the GTOCs and two of their nonregulated affiliates. The audit revealed that the nonregulated affiliates achieved excessive rates of return in their sales of services to the GTOCs and that the resulting excessive costs to the GTOCs were passed on to ratepayers. The terms of the Consent Decree required the GTOCs to file rate reductions, make a contribution to the United States Treasury and undertake other remedial actions.[24/] Similar findings as to excessive nonregulated affiliate earnings were made in an earlier audit of transactions between BellSouth Corporation's operating companies and a nonregulated subsidiary.[25/]

A month after the GTOC Consent Decree was entered, the Commission released a federal-state joint audit examining transactions between Southwestern Bell Telephone Company (SWBT) and various of its affiliates, including its parent, Southwestern Bell Corporation (SBC). The audit report found a lack of supporting documentation for time charged by SBC employees for work done for SWBT, use of an improper marketing allocator and

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[24/] Consent Decree Order, The GTE Telephone Operating Companies, AAD 94-35, FCC 94-15 (released April 8, 1994).

[25/] BellSouth Affiliate Transaction Audit: Summary of Audit Findings (undated). See BellSouth Corporation, et al., AAD 93-127, FCC 93-487 (released Oct. 29, 1993).